

— NAVIGATING UNCERTAIN TIMES – CHALLENGES AND LESSONS

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Smoothing out the retirement wrinkles

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Hold tight

PATRICE RASSOU

Chief Investment Officer

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“Amid risk there is always opportunity, and the cycle will most assuredly turn if you just hang on tight.”



There is no hiding from market volatility in a world battered and bruised by the Coronavirus (Covid-19) and staring down the barrel of the fallout from a war on the outskirts of Europe.

When we were in the process of envisaging the first issue of *Global Perspectives* back in January 2022, our focus on market volatility hinged on a post-pandemic reality, the continued fallout from Covid-19, the change in monetary regime to more tightening and the bubbling inflationary pressures around the world. Then, in February 2022, Russia invaded Ukraine.

The weeks that followed saw the European Union, the US and the UK, among others, imposing strict sanctions on Russia, and


later their core ally Belarus. These included banning a number of these countries' banks from the global SWIFT financial messaging service, freezing company and oligarch assets, instituting travel bans and, for some, an all-out halt of imports of Russian oil, coal and liquified natural gas. The Russian rouble promptly collapsed by 40% to all-time lows and there was even a run on some Russian banks.

Ratings agency Fitch noted a number of credit risks associated with the conflict in early March, highlighting expected hikes in agricultural commodities, rising oil and fuel prices, and increasing inflationary pressures and downgraded the rating of several Russian banks. For some emerging markets the risks are


even higher, noted Fitch, singling out greater risk aversion among international investors, the impact of a stronger US dollar and increased challenges raising debt on global markets.

Suddenly our focus on navigating market volatility took on a whole new hue.

It is hardly surprising that the unfolding conflict features prominently in this edition of *Global Perspectives*, but it is important to remember that the fundamentals of investing through good times and bad remain unchanged, irrespective of the geo-political fallout and market pressures of the day.



“It is important to remember that the fundamentals of investing through good times and bad remain unchanged, irrespective of the geo-political fallout and market pressures of the day.”

 PATRICE RASSOU

Albert Botha provides us with a glimpse into the fallout already evident from the Russia-Ukraine conflict, along with some sage words on how best to protect your money during wild times. I have contributed a piece to this edition, one that speaks to the importance of getting the basics right when crafting an investment portfolio – this way, when the tide goes out, you won't be shocked to find your picks have been swimming naked all along.

Adam Drewry adds his voice to the volatility debate by unpacking the role asset allocation plays in building robust portfolios and how even with a solid understanding of macroeconomics there is always room for a touch of art in the science of investing.

Since there is a great deal of focus currently on inflation and interest rates, we've also included an article by Mathew John which

explores the correlation between these two phenomena and asks what this means for investors and for the JSE as a whole. And, finally, Vicki Tagg takes a look at the new FNB Core Balanced Fund managed by Ashburton Investments and its place as a low-cost, passive building block solution in the retirement space.


There is a lot going on globally and locally at the moment. Nerves are on edge and uncertainty is building around the current and future implications of unfolding events. It is at times like these that a solid plan of action, the input of skilled professionals and adherence to meaningful investment principles is essential. Amid risk there is always opportunity, and the cycle will most assuredly turn if you just hang on tight.

With all the changes happening around us, we've also had a few changes within our business.

On 1 March 2022, we welcomed our new CEO Duzi Ndlovu who has taken over from Sizwe Nxedlana. Duzi has a long history in the investment industry and is well placed to lead Ashburton Investments' next growth phase.

We have also strengthened our investment team and capability in recent months. The team has grown with key additions such as Charl de Villiers as head of equities.

Our equities and balanced funds have been restructured and are seeing good performance. Our flagship the Ashburton Stable Income Fund and the Ashburton Diversified Income Fund have experienced top quartile performance over one year. We are grateful to our clients for the continued support and look forward to taking you along in our next growth phase.





When the tide goes out

PATRICE RASSOU

Chief Investment Officer

The invasion of Ukraine by Russian troops in February 2022 has only served to exacerbate volatility and uncertainty.

Global investors could not even find safety in US government bonds with yields surging at the beginning of this year from 1.4% to pass 2%.

For more risk averse investors, our fixed income range of funds remains best in class with the Ashburton Diversified Income Fund providing an excellent income solution for clients in search of yield.

“Calm waters in investing belie the occasional tsunami that has the potential to cause untold destruction when it unexpectedly hits.”

Warren Buffett, one of history's most successful investors, famously coined the phrase: “Only when the tide goes out, do you discover who's been swimming naked.”

While no company ever really wants to be among those caught in their altogether when the going gets tough, sometimes investors can be forgiven for gauging the investing waters to be as warm and soothing as a weekend outing to Fish Hoek.

Calm waters in investing, however, belie the occasional tsunami that has the potential to cause untold destruction when it unexpectedly hits.

Back in the late '90s, the tech bubble had led to a doubling in value of global equities over a three-year period, before subsequently halving in just over a year. Between 2003 and 2008 global equities climbed up the stairs again to beat previous record highs, only to fall by 60% in a year following the collapse of Lehman Brothers.

BASE 100 OF FTSE WORLD INDEX (US\$)



Source: Inet

Yet again, stocks took the fast elevator on the way down.

Since the GFC, global equities again took the long flight of stairs up to treble in value just before the global health crisis caused by the Covid-19 pandemic struck in 2020.

After falling sharply by a third, global equities continued climbing and, along the way, broke multiple record highs.

To explain why global equities have quadrupled in value since the GFC, one must look no further than the massive amount of quantitative easing undertaken by central banks around the world over the past decade, causing their balance sheets to swell almost fivefold. This was accompanied by near zero and even negative interest rates in the developed world.

BETTING ON GROWTH STOCKS

During this era of cheap money, growth managers became household names with the top billing being given undoubtedly to Cathie Wood, who very early on was able to identify disruptive companies and invest in them via her flagship ARK Innovation Exchange Traded Fund (ETF). Retail investors were able to access the venture capital-like tech portfolio via a transparent exchange traded vehicle and were rewarded with fourfold returns from 2018 to the beginning of 2021. Valuations did not seem to matter as the hunt for investment opportunities extended to stocks with no earnings – it was all about invest now, grow fast to secure rewards in the far future.

The COVID-19 gridlock also unleashed a new generation of DIY investors, many of whom were lured by free brokerage accounts offered by US firms such as Robinhood and were intent on picking up bargains following the

bloodbath the pandemic caused on financial markets. The army of retail traders even took on hedge funds by buying up heavily shorted stocks like GameStop, a struggling electronics and video game retailer, forcing professional investors to run for cover as prices shot up, defying any fundamentals.

AN INFLATION PROBLEM

What has been questionable is the US Federal Reserve's (Fed's) stubborn view that inflation would be transitory while data analysed by our global strategy team was indicating a clear broadening of inflationary pressure.

In mid-December 2021, Fed chairman Jerome Powell capitulated by admitting that inflation in the US was more persistent than previously thought and warned that the Fed would close the liquidity hosepipe by March this year. To add insult to injury, there was a warning that rate hikes would come earlier rather than later.

“It is hardly surprising that energy prices shot up, since Russia and Ukraine both supply Europe with 40% of its gas needs.”

All this contributed to an extremely volatile first month of 2022.

The S&P 500 gyrated wildly, even plunging 4% intraday following the Federal Open Market Committee meeting before closing in the green – such reversals have only been witnessed twice before. The Nasdaq composite, with its line-up of growth stocks, was down by more than 9%, its worst month since the Covid-19 crisis.

DRUMS OF WAR

The invasion of Ukraine by Russian troops in February 2022 has only served to exacerbate volatility and uncertainty. It is hardly surprising that energy prices shot up, since between them Russia and Ukraine supply Europe with 40% of its gas needs. Russia is also a significant exporter of oil, a major producer of platinum group metals and a top supplier of gold. Not surprisingly, the price of metals has also shot up as a result of the conflict. In addition, with a fifth of global wheat production coming from Russia, even soft commodity prices have been impacted.

South African companies have a limited footprint in Russia – with Barloworld and Mondi coming to mind – but it is likely

that commodity producers will benefit from a short-term windfall. However, concerns remain that the world cannot afford another crisis and the unfolding events in Eastern Europe spell bad news for European industry, that is unless a rapid resolution to the conflict is found.

NOWHERE TO HIDE

Global investors could not even find safety in US government bonds with yields (which move inversely to the price of the instruments) surging at the beginning of this year from 1.4% to pass 2%. The winners in the equity bull run also unravelled with the ARK Innovation ETF halving in the past year. GameStop, the darling meme stock, also halved since December and Ethereum, the best performing crypto currency last year, sold off. In addition, we saw Meta Platform Inc – fresh from its Facebook makeover – break the record of the largest daily loss in market cap of US\$232 billion. In rand terms that's a loss of R3.5 trillion in single day.

January, however, was also a live example for us to stress test Ashburton Investments' equity funds.

The Ashburton Global Leaders Equity Fund, with its focus on quality stocks, outperformed most of its rivals during the month, more than living up to its quality label in the process. The restructured Ashburton Equity Fund also had a particularly good start of the year, navigating the market volatility well.

For more risk averse investors, our fixed income range of funds remains best in class with the Ashburton Diversified Income Fund providing an excellent income solution for clients in search of yield. Our absolute return fund, the Ashburton Targeted Return Fund continues with its aim of preserving capital over a rolling one-year period while comfortably beating inflation. These performances should provide comfort to our investors that Ashburton Investments' rigorous investment process can cater for all investment needs during volatile times.

As quantitative easing begins to give way to quantitative tightening, much of the excess of the past decade will soon be flushed out. It is in this pool of water that investors should be watching for those who are swimming naked.

Navigating market volatility the global multi asset way

ADAM DREWRY

Investment Manager Global Multi Asset

Without a doubt, the global lockdowns in early 2020, in response to the Covid-19 pandemic led to a volatile investing environment.

At Ashburton Investments, we believe that when it comes to navigating market volatility, a forward-looking and dynamic approach to asset allocation is best.

Heading into 2022, we are seeing a less favourable outlook for US economic growth.

To say the last few years have been eventful would be an understatement.

Without a doubt, the global lockdowns in early 2020, in response to the Covid-19 pandemic led to a volatile investing environment. Equity markets were quick to price in the economically devastating effects of the shutdowns and had the quickest peak-to trough declines in history, plunging by more than a third in less than a month. The subsequent recovery was as swift, clawing back the entire loss in merely six months.

It is worth noting that the economic contraction was unprecedented as US nominal gross domestic product (GDP) year-on-year fell

8.5% in the second quarter of 2020, although the recovery was equally as remarkable with growth surging 16.8% in the corresponding period in 2021.

The speedy recovery in equity prices can not only be ascribed to a strong recovery in consumer demand as Covid-related restrictions were removed, but also to the most supportive monetary and fiscal policy by global authorities on record. In fact, the US Federal Reserve (Fed) slashed the Federal Funds Rate from the upper bound target rate of 1.75% in January to just 0.25% by the end of March 2020. At the same time the Fed initiated an extraordinary quantitative easing programme which saw its balance sheet more than double from slightly more than US\$4 trillion

before the pandemic to a little shy of US\$9 trillion two years later.

The strong US economic recovery in 2021, combined with stubbornly high inflation (January 2020 Consumer Price Index of 7.5% year-on-year), resulted in a hawkish monetary policy stance by Federal Open Market Committee members.

Now, as we navigate our way through 2022, the withdrawal of liquidity from financial markets (as the Fed starts the process of quantitative tightening) is likely to lead to further market volatility.

This is an environment in which we believe a well-diversified global multi asset portfolio that is both forward-looking and dynamic in its asset allocation should stand out from its peers.





“The withdrawal of liquidity from financial markets is likely to lead to further market volatility.”

ASSET ALLOCATION ADVANTAGE

Most modern-day approaches to asset allocation have evolved from the origins of modern portfolio theory (MPT) and the mean-variance framework set out by economist Harry Markowitz in 1952. Markowitz's mean-variance framework demonstrated the concept of diversification by constructing portfolios using various uncorrelated instruments to build a portfolio with the same level of expected return but with a reduced level of risk when compared to the sum of its parts. One of the most common asset allocation tools to come out of MPT is the mean-variance optimisation model, which allows investors to identify the optimal portfolio mix that maximises the expected return for a given level of risk.

While this approach is used as a starting point for asset allocation, it is backward looking and extrapolating the inputs can make expected return, risk and correlations unreliable. The non-linearity of markets must be embraced in a suitable framework that gives true diversification potential that is relevant for the future state of the investment climate.

At Ashburton Investments, we believe that when it comes to navigating market volatility, a forward-looking and dynamic approach to asset allocation is best. Accordingly, we put more emphasis on asset allocation tools such as the Black-Litterman model, which allows our teams to incorporate their own market expectations and confidence levels for various scenarios.

ART AND SCIENCE

While the use of quantitative tools, such as the Black-Litterman model, provides a framework for making asset allocation decisions, the real art comes from understanding the business cycle in the context of global fiscal and monetary policy and then identifying key fundamental macroeconomic trends driving asset class returns. Ultimately, these key macroeconomic trends create the inputs to our dynamic asset allocation process.

For example, the strong rebound in US economic growth paired with significantly easy monetary and fiscal policy in 2021 resulted in the Ashburton Global Multi Asset Fund range being maximum overweight equity within our predefined risk parameters for much of last year.

This included a notable bias to economically sensitive US equity sectors such as energy and financials while being underweight duration within fixed income.

Heading into 2022, we are seeing a less favourable outlook for US economic growth. This, combined with tighter monetary policy, means that asset allocation across the fund range is far more neutral with a specific underweight to US equities and an overweight to less highly valued Southeast Asian equity regions that have a much more favourable growth backdrop.

The fluidity of our approach, which includes being contextually aware of the various macroeconomic cycles, gives us an edge over our peers and enables us to deliver suitable risk-adjusted returns for our clients.

Both the Ashburton Global Balanced USD I share class and Global Growth USD I share class outperformed their respective Morningstar peer groups in 2021. The Ashburton Global Balanced Fund returned 9.95% compared to the Morningstar EAA Fund USD Moderate Allocation peer group of 7.26%, while the Ashburton Global Growth Fund returned 13.87% against the Morningstar EAA Fund USD Aggressive Allocation peer group of 11.63%.



US interest rates, inflation and the JSE

MATHEW JOHN

Head of Quantitative Research and Data Science

Investing at the moment is no longer a case of shooting fish in a barrel, but it is the moment for clear heads, plentiful research and astute strategies.

The ongoing Russian invasion of Ukraine is forcing energy prices upwards which, in turn, leads to a further increase in household bills.

Equities as an asset class are expected to beat inflation.

“The anticipated rate hikes can be treated as a continuation of the 2016 hike cycle to tackle a decade of quantitative easing.”

Causal reasoning evaluates whether an event has a cause-and-effect relationship to another event, or if they just happened to occur at the same time.

Right now, for instance, the economic news cycle is mulling over inflation, and global central banks are trying to deal with rising inflation by applying rate hikes, more

of which are anticipated. This leads to the question of whether there is a true cause-and-effect relationship between inflation and the US Fed interest rate.

In theory, there should be an inverse relationship. Or are we dealing with something akin to the Latin fallacy ‘Post hoc ergo propter hoc’, which translates to: ‘after this, therefore because of this’.

BACKGROUND

We are now two years on from March 2020, the onset of the global Covid-19 pandemic and the associated market turmoil. Figures 1 and 2 show the two years following the global financial crisis (GFC) market crash and the Covid-19 outbreak respectively. The Nike swoosh shape of the Covid-19 crash in US markets and recovery is strikingly different from the L-shaped situation in 2008 when markets only recovered from the GFC by 2015. Conversely, one of the many reasons for the fast recovery from the recent crash could be the quicker and bigger response from central banks, particularly the US Fed.

By 2015, once the market had recovered from the GFC, the Fed began to strategically raise interest rates with little market chaos. When the pandemic shock came in 2020, this crisis replaced the tightening plan with an accelerated easing plan. So, the anticipated rate hikes can be treated as a continuation of the 2016 hike cycle to tackle a decade of quantitative easing. The inflation problem the Fed was trying to address in 2016 has grown from year-on-year CPI of 2-3% to 7-8%.

FIGURE 1: CRASH AND RECOVERY - GLOBAL FINANCIAL CRISIS (2007-2009)

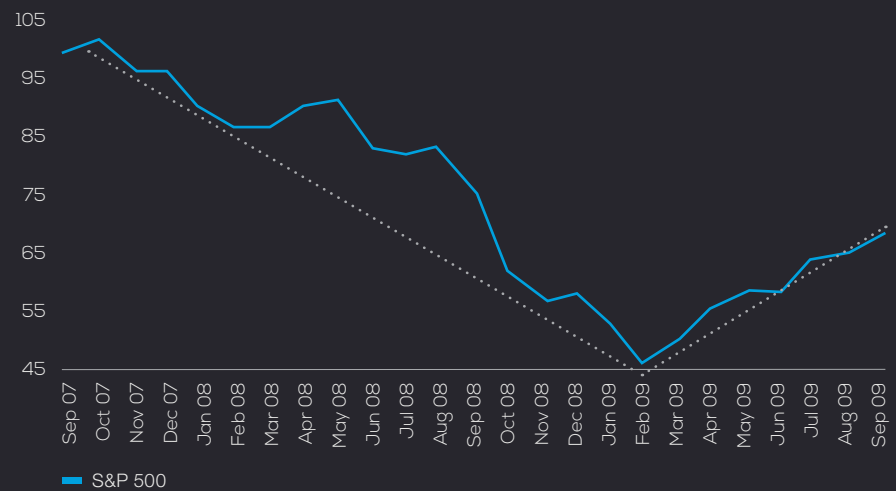
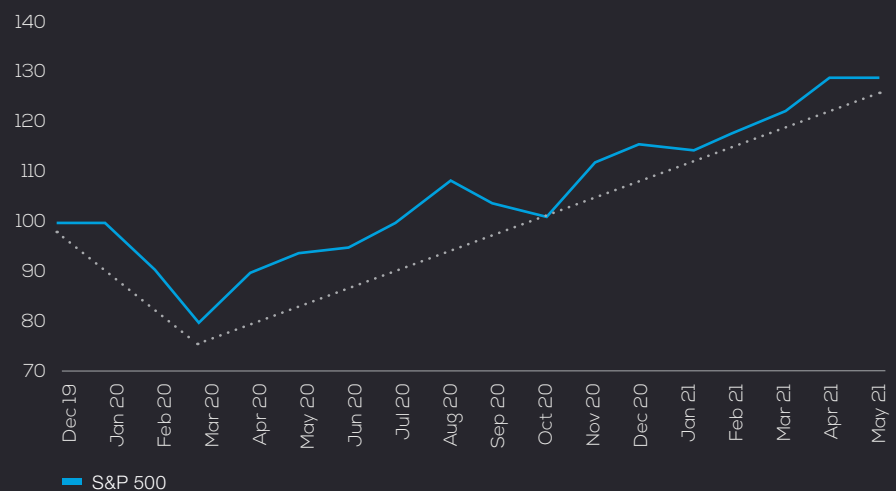


FIGURE 2: CRASH AND RECOVERY - COVID-19 (2019-2021)



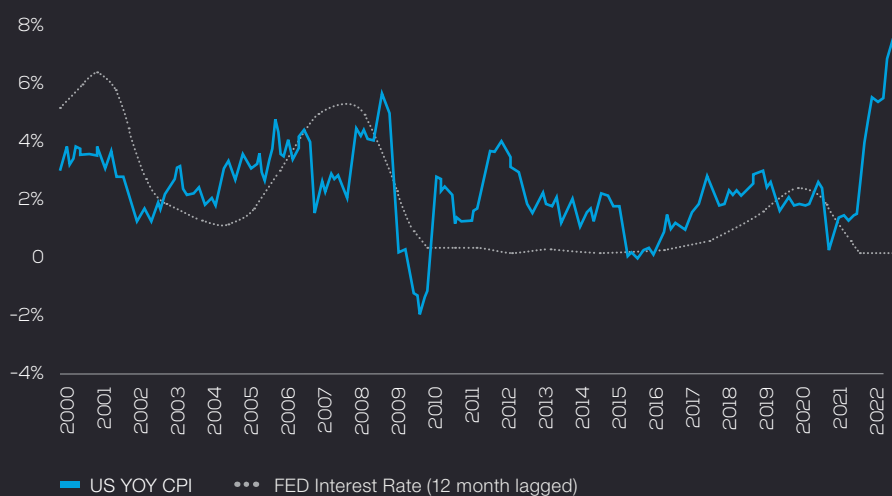
“When the pandemic shock came in 2020, the crisis replaced the quantitative tightening plan with an accelerated quantitative easing plan.”

UNPICKING THE RATE-INFLATION RELATIONSHIP

Having set the stage, let's now try to evaluate the relationship between Fed rates and inflation by using a simple linear regression between the two variables to see whether one is the solution for the other.

In Figure 3, a 22-year regression of US interest rates (12 month lagged) as the independent variable and US year-on-year CPI gives a low R square of 0.11. There is a strange low positive correlation of 0.34 instead of an expected negative number, which would represent an inverse relationship. The rolling correlation over time explains, in part, the lack of explanatory power of US interest rates on CPI. The relationship is behaving more like a cyclical phenomenon switching between strong positive and negative correlation (as illustrated in Figure 4).

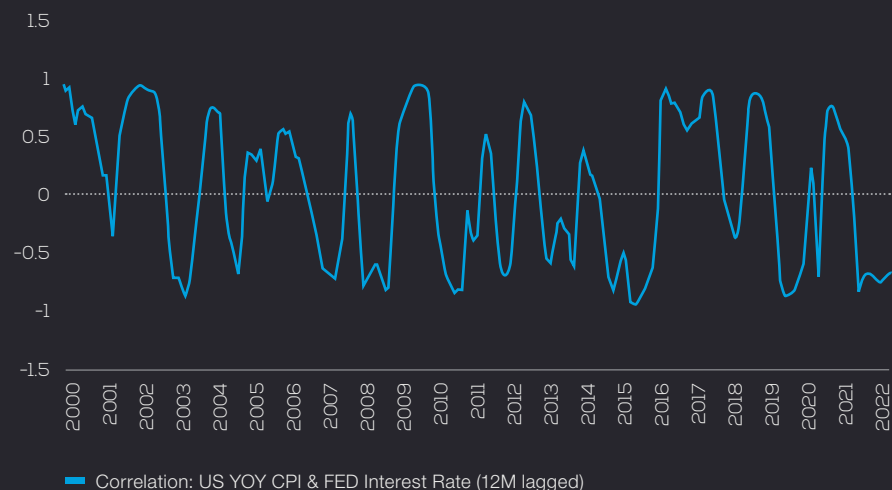
FIGURE 3: CAUSALITY TEST - US INFLATION VS. FED INTEREST RATES



Source: Bloomberg, Ashburton Investments

Currently we are seeing a strong negative correlation. In fact, for inflation to come down with rate hikes, it would need to stay negative instead of going cyclical. The mean reverting nature of asset prices explains inflation cycles in a more intuitive way, which takes us into the next point: the opportunity universe.

FIGURE 4: CORRELATION - US YEAR-ON-YEAR CPI AND FED INTEREST RATE



Source: Bloomberg, Ashburton Investments

JSE OPPORTUNITY UNIVERSE

Although volatility indices, such as the CBOE VIX and JSE SAVI Index, measure implied volatility, the opportunity set measurement is more intuitive by calculating the magnitude of winners/losers from the broader market index, the cross-sectional volatility index.

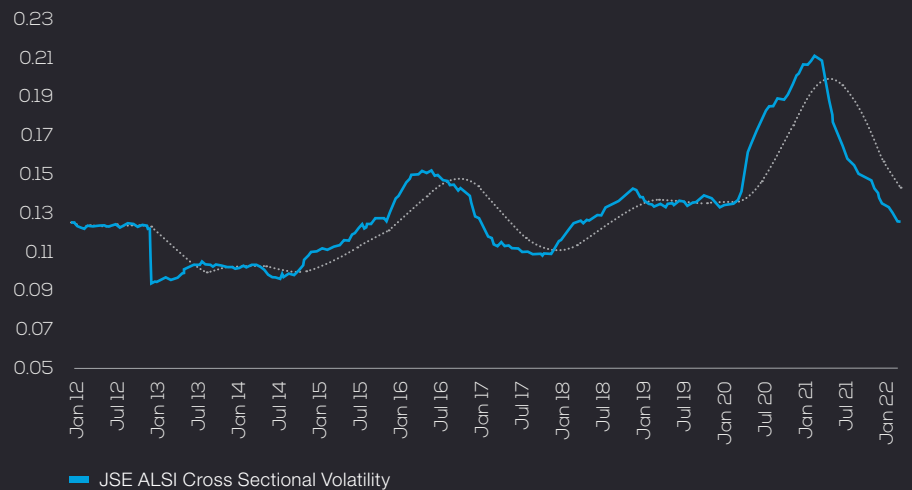
Cross-sectional volatility measures the size of the opportunity set or

the standard deviation of asset returns relative to the broader market index. A certain level of cross-sectional volatility is needed for active managers. After all, one can only pick winners relative to a broader index if winners exist. However, when the opportunity set is too wide, everyone is a winner.

We went through a similar period over the last two years. The higher probability of positive returns in a

low inflation environment was the past regime. The cross-sectional volatility graph from March 2020 to quarter two of 2021 illustrates this (Figure 5). But the cross-sectional volatility graph has changed direction, indicating the opportunity universe is narrowing. In other words, there are fewer winners compared to the market, which makes stock picking difficult.

FIGURE 5: JSE ALSI CROSS-SECTIONAL VOLATILITY



Source: Bloomberg, Ashburton Investments

“The higher probability of positive returns in a low inflation environment was the past regime.”

IN A NUTSHELL

Currently South African inflation is at 5.7%, below the US inflation number of 7.5% in February 2022. The ongoing Russian invasion of Ukraine is, however, forcing energy prices upwards which, in turn, is likely to lead to a further increase in household bills.

Right now, the negative real return risk for the investor - as mentioned at the start of this article - needs a mitigation strategy. Equities as an asset class is expected to beat inflation. But since the equity opportunity set is not as wide as it used to be, equity exposure needs to be an actively selected and curated list of businesses that have stood the test of time and are priced right.

Investing at the moment is no longer a case of shooting fish in a barrel, but it is the moment for clear heads, plentiful research and astute strategies.



Before you shift all your assets to the US, it's worth noting that over the six months to the end of February 2022, the South African market outperformed the US market by more than 10% in rand terms.

Diversification is a drum beaten by every asset manager and every adviser when they sit down with a client.

We spend our lives selling our time for money and yet we still seem to underappreciate its value.

How to protect your money during wild times

ALBERT BOTHA

Head of Fixed Income,

If there was ever a time for investors to reflect on how they should protect their capital, the past two years have been it.

Global pandemics, local riots and now the unfolding war in Ukraine are just some of the events that have rattled portfolios. Policies around the movement of people and their participation in the economy, the unprecedented application of monetary policy and the rising impact of inflation have also muddied the waters. These events have resulted in various sell-offs and price spikes in almost all major markets, dragging down investor sentiment and portfolio performance.

In China, a combination of the historic oversupply of property* alongside some changes in local policies led to a drop of almost 15% in the country's stock market between the highs of February 2021 to the rude awakening of December 2021. China has recently shifted to a common prosperity policy which aims to reduce inequality in its society after declaring that poverty has been eradicated. Over that same period the US stock market rallied 21.9%. Yet before you shift all your assets to the US, it's worth noting that over the six months to the end of February 2022, the South African market outperformed the US market by more than 10% in rand terms.

Even before the war in Ukraine there was already a significant degree of uncertainty regarding rates,

inflation and global gross domestic product growth over the next 12 to 24 months. Inflation was high and drifting higher along with some truly staggering numbers coming out of Europe for its Producer Price Index (PPI). The year-on-year change in German PPI rose to 25% in January, the highest number since 1977. The previous high came in at 9.2% back in 1981. It is worth noting that this record PPI change in Germany was recorded before the massive increase in energy costs hit in March 2022.


Oil has spiked to levels not seen in multiple years – breaching US\$125 a barrel in the first weeks of March. Yet, while this is very high in a more recent context, the average oil price from 2011 to 2014, adjusted for the US Consumer Price Index, would imply an equivalent level of around US\$165/barrel today. The 2008 high equivalent would mean oil at just above US\$250.

Nickel is probably the commodity that had the most severe reaction amid the Ukraine-Russia crisis, spiking more than 250% from the first to the eighth of March on a short squeeze. This forced the London Metals Exchange to close and even take the unprecedented step of reversing some already executed trades.

There are dozens of examples that one can point to over the last two years that demonstrate the increase in uncertainty and related volatility. Bitcoin, Ethereum, non-fungible tokens and GameStop being among the most well-known, but not the most extreme.

“There are dozens of examples that one can point to over the last two years that demonstrate the increase in uncertainty and related volatility.”

* See China Common Prosperity policy.



“There are three things every investor needs to remember to help reduce risks: diversification, prudence and time.”

SO, WHAT CAN BE DONE TO SAFEGUARD YOUR CAPITAL?

The root of most of the mistakes people make during uncertain and volatile times lies in greed and fear. “Everyone has made money from crypto,” rings out, and so you pile in at the top. “The market is down 30%,” is the cry, so you sell at the bottom.

To help temper these voices, there are three things every investor needs to remember to help reduce these and other risks.

Firstly, diversification is a drum beaten by every asset manager and every adviser when they sit down with a client. As has been said many times before, diversification is the one ‘free lunch’ available in the markets. It reduces drawdown, smooths the ride and reduces country specific risk. Most clients tend to have too much concentration in assets which they can easily access, and they fear diversifying offshore.


Or when they do invest more outside South Africa, they often invest in narrative assets such as Tesla or Bitcoin. Always consider your distribution of risks and your potential regional and home country bias whenever you review your portfolio.

Prudence is the second important thing that often goes out the window during challenging times. Stories about 100% gains in a year and being 10 times up in Bitcoin abound – yet it is not often that you hear of that 99% loss on a GameStop or rouble position. Investors quite often have unrealistic expectations and those lead to chasing the latest fad, overtrading and taking more risk than is appropriate. The global equity markets tend to provide a return of between 6% and 7% above inflation over the long term. Hence consistently trying to get much more than that is never a feasible goal. Always searching for it is likely to lead you to the same end as the conquistadors searching for El Dorado.

The final fundamental is time. We spend our lives selling our time for money and yet we still seem to underappreciate its value. Much is made of the genius of Warren Buffett, but the one thing books never seem to mention is that much of the reason for his immense wealth is that he has spent the last 80 years compounding his portfolio. He bought his first share at the age of 11 and is now 91 years old. To put it another way – more than 50% of Buffett’s personal wealth has only accrued to him in the last five years as Berkshire Hathaway shares doubled during that time.

Eighty years of investing and the last five have given Buffett more than the first 75 years combined.

So, if you really want to learn from the ‘Sage of Omaha’: save early and save often. Time is your ally in investments, but only if you also follow steps one and two.





VICKI TAGG

Head of Indexation

Smoothing out the retirement wrinkles

While South Africa has a well-developed and sophisticated retirement savings industry, it is not designed to encourage the preservation of retirement funds when moving jobs.

With financial inclusion and long-term, sustainable steady returns top of mind, our investment philosophy is not to take big cyclical bets but to add value to the client over time.

Through this fund, it is our hope that more and more South Africans have the option to retire – or not – on their terms, just like the indomitable Betty White.

When Betty White passed away, aged 99, the internet was filled with tributes to this beloved American actress and comedian. Among those witticisms attributed to Betty was this one: “Retirement is not in my vocabulary. They aren’t going to get rid of me that way.”

In the end, Betty was - as ever - true to her word. It was her choice to never spend a single day in retirement. But, for some, retiring may not even be an option. Many people around the world simply have no choice but to forgo a well-deserved rest from the day-to-day grind during their old age and must continue plugging away for as long

as possible to try to fill the savings gap. This is a common reality in South Africa.

Our research colleagues have pointed out that at 14.65% of gross domestic product (according to World Bank figures), South Africa's household savings rate is extremely low compared to global averages. While South Africa has a well-developed and sophisticated retirement savings industry, it is not designed to encourage the preservation of retirement funds when moving jobs. We know just how tempting it is to take that cash, thinking of debts to be settled, while promising ourselves that we'll replace it some point in the future. Of course, more often than not, that point never arrives.

“Retirement is not in my vocabulary. They aren’t going to get rid of me that way.”

BETTY WHITE

Fortunately, it’s not all doom and gloom since there are regulatory reforms in progress that aim to promote higher savings, expand retirement coverage to more employees, encourage better preservation and reduce the cost of retirement savings.

It’s against this backdrop that Ashburton Investments, in conjunction with FNB Wealth and Investments, developed the FNB Core Balanced Fund. The fund’s focus is simple: to provide a very low-cost balanced fund that uses passive building blocks so that performance is not eroded by high fees. This is critically important as compounding the low savings problem in South Africa is the relatively high costs associated with many retirement savings products. In fact, investors are often not aware of how detrimental high fees can be to an investment over time.

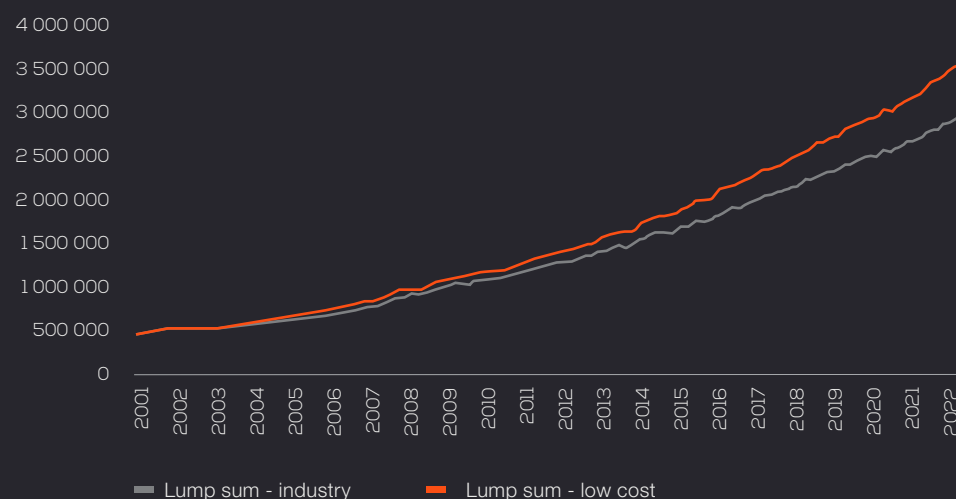
We developed this portfolio by examining industry trends, which show an ever-increasing demand for passively managed solutions at total investment costs (TICs) far below those of the current asset managers which dominate the South African balanced fund landscape.

With financial inclusion and long-term, sustainable steady returns top of mind, our investment philosophy is not to take big cyclical bets but to add value to the client over time. We use internal building blocks at zero fees to ensure that they pay the lowest possible cost while earning the highest possible returns. We target a total investment cost of 0.39% for the fund.

HOW DOES THIS WORK IN PRACTICE?

To illustrate how the fund’s philosophy works, Figure 1 shows the performance of a R500 000 lump sum invested in the FNB Core Balanced Fund with a TIC of 0.39% versus an average balanced fund at a TIC of 1.30% (with all other factors being equal). Over 20 years, just due to the cost differential, this investment would outperform the industry fund by 19.79%, resulting in a lump sum of R3 580 696 on retirement, compared with the industry balanced fund’s performance of R2 989 106. That’s an additional R591 590 in the investor’s pocket.

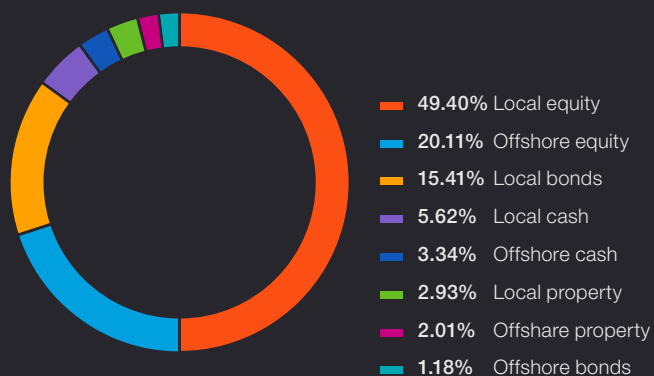
FIGURE 1: PERFORMANCE DIFFERENCE OF R500 000 OVER 20 YEARS



“The solution is inspired by our ambition to create financial solutions that truly benefit all South Africans.”

For investors looking for a long-term multi-asset investment providing inflation beating (CPI + 5%) and capital growth, a Regulation 28 fund (like the FNB Core Balanced Fund) is a good option since it spreads the investment - and therefore the risk - over various asset classes under the guidelines of Regulation 28. Below is the asset allocation of the fund, as at December 2021.

ASSET ALLOCATION



Source: Morningstar®, Ashburton Investments

OUR APPROACH TO ADDING VALUE

The fund adds value in two ways. Firstly, clients save around 1% per annum in total investment costs compared to some of the well-known balanced funds in the market. We do this by using an active asset allocation strategy into a diversified range of core local and offshore passive investments. This approach brings together the benefits of an actively managed fund with the cost benefits and transparency of passive underlying building blocks.

By using index trackers, we are assured of getting benchmark returns in each of the asset classes, so there's little risk of significantly underperforming the benchmark. Historically, outperforming the benchmark, specifically in the equity space, has proven to be difficult.

In recent years we've seen passive balanced funds growing in popularity as investors realise the important positive impact of compounded low costs on performance over the long term. Amid this market trend towards passive balanced funds, the FNB Core Balanced Fund gives clients the advantages of both active and passive investing in one product.

Secondly, the solution is inspired by our ambition to create financial solutions that truly benefit all South Africans. Through this fund, it is our hope that more and more South Africans have the option to retire – or not – on their terms, just like the indomitable Betty White.



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